

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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PLR-141044-06

Date:

February 20, 2007

LEGEND

X =

A =

Trust B =

Corp C =

D =

E =

F =

G =

Trust H =

LLC =

State =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

D7 =

D8 =

D9 =

a =

b =

c =

d =

e =

f =

z =

Dear _____ :

This letter responds to a letter dated August 16, 2006, submitted by X's authorized representative on behalf of X, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was established on D1 and recognized by the State Secretary of State's office as a corporation on D2. X elected to be an S corporation effective D3. On D5, A contributed z shares of X to LLC, a State limited liability company. LLC is an ineligible S corporation shareholder. Therefore, X's S corporation election terminated on D5.

LLC was formed in D4. Its original members were A, who, through Trust B, owned a a% interest in LLC, and Corp C, a subchapter S corporation which owned the remaining b% interest in LLC. A, as the trustee of Trust B, is the sole shareholder of Corp C. On D6, A gifted a c% interest in LLC to D, as well as d% interests each to E, F and G. At the same time, D contributed her c% interest in LLC to Trust H. On D7, A gifted an additional e% interest each to E, F and G. On D8, Trust H transferred an f% interest to A as trustee of Trust B. Trust B and Trust H are grantor trusts under § 671.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and not motivated by tax avoidance or retroactive tax planning. X and its shareholders have also agreed to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

X further represents that it did not become aware until D9 that the contribution of shares to LLC caused the termination of X's S corporation election. Additionally, X represents that LLC's interest in X will be distributed to A (through Trust B), Corp C, D (through Trust H), E, F, and G, and that the interest distributed to Corp C will be immediately distributed to A, as the trustee of Trust B. Thus, all shareholders of X will be eligible shareholders of X.

Section 1361(a)(1) defines an S corporation as a "small business corporation" for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that a "small business corporation" cannot have as a shareholder a person (other than an estate and other than a trust described in § 1361(c)(2) or an organization described in § 1361(c)(6)) who is not an individual.

Section 1362(d)(2) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the taxable year for which a corporation is an S corporation) such corporation ceases to be a small business corporation. A termination of an S corporation election under § 1362(d)(2) is effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under paragraph (2) or (3) of § 1362(d), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based solely on the facts represented, we conclude that X's S corporation election was terminated on D5 when LLC, an ineligible shareholder, acquired X stock. We also conclude that this termination was inadvertent within the meaning of § 1362(f).

Therefore, we conclude that X will continue to be treated as an S corporation for the period from D5 and thereafter, provided that X's S corporation election was valid and provided that the election was not otherwise terminated under § 1362(d). The shareholders of X must include their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Additionally, during the termination period and thereafter, the following eligible S corporation shareholders will be treated as the owners of the X stock acquired by LLC, for the following periods of time: From D5 until the day before D6, A (through Trust B) will be treated as the owner of the X stock; from D6 and thereafter, A (through Trust B),

D (through Trust H), E, F, and G will be treated as the owners of their respective shares of X stock, taking into account the changes in ownership percentages that occurred on D6, D7 and D8. If LLC's interest in X is not distributed to the eligible S corporation shareholders as represented by X – specifically, with (1) LLC's interest in X first being distributed to A (through Trust B), Corp C, E, F, G and D (through Trust H) and (2) the interest distributed to Corp C being immediately distributed to A, as the trustee of Trust B – this letter ruling will be null and void.

Except as specifically ruled above, we express no opinion concerning the federal income tax consequences of the facts of this case under any other provision of the Code. Specifically, no opinion is expressed regarding X's eligibility to be an S corporation or the validity of its S corporation election.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

J. Thomas Hines
Chief, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)